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DEPT FOR EUR/SCE JISMAIL, TREASURY FOR VIMAL ATUKORALA

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TAGS: EFIN ECON AL
SUBJECT: ALBANIA: HEAD IN THE SAND?

REF: TIRANA 653

Classified By: Ambassador J. Withers, reasons 1.4 (b), (d)

Summary

¶1. (C) Prime Minister Berisha appears so obsessed with winning the 2009 election that he seems totally oblivious to the possible economic problems facing Albania. Although the IMF and other international financial institutions (IFI) have forecast a relatively smooth passage through the global financial crisis, Albania's fragile economy is exposed to several external factors over which the GOA has no control. Weakening economies in other countries could cause a reduction of remittances, which could have a domino effect by reducing construction activity and causing depositors to accelerate their withdrawals. As banks see their deposits decreasing, they could become more reluctant to buy government securities, causing a widening of the budget deficit. Finally, these factors could reduce the leke-euro exchange rate, hurting many borrowers who have taken out euro-denominated loans. While the probability of any of these events is unknown, a responsible government should plan for the worst, something the PM seems unwilling to do. End Summary.

Albania Is Only Partially Protected

¶2. (C) In the IMF's latest report, Albania's six percent GDP growth rate for 2008 is forecast to soften to 4.5 percent in 2009 because of the global financial crisis. A recent Economist report suggested that 2009 GDP might fall only slightly and remain just below six percent. Prime Minister Berisha has pointed to these reports and taken the position that all is well. His focus on winning the 2009 elections seems to have caused him to ignore potential problems raised by the IFIs.

Remittances and Foreign Jobs Are Key

¶3. (C) Although somewhat insulated from the turmoil in global markets, Albania could still face financial troubles caused by events it has no control over. For instance, Albania's economy is highly dependent on remittances, which comprise about 14 percent of GDP. If remittances continue to decline as they have over the last few months, a domino effect could ensue. While there are no data connecting remittances with construction or other elements of the economy, international experts believe that a decline in remittances would reduce construction activity with a subsequent loss of jobs. Another portion of remittances is deposited into bank accounts. Declining remittances could cause some depositors to reduce their deposits or accelerate their withdrawals.

¶4. (C) Although many Albanians have taken residence in foreign countries, there are many temporary or seasonal workers abroad. A softening in the economy of their host countries could force many of these workers to return home, adding to the financial burden on their families in addition to the loss of foreign earnings.

The Budget Deficit and Exchange Rate

¶5. (C) The Central Bank has noted that withdrawals have declined over the last two months but have recently stabilized. Clients could increase their withdrawals once again for any of a number of reasons, including the failure of a weak Albanian bank, loss of family income, or alarming news of some kind from abroad. If depositors once again begin to draw down their accounts, banks would have less money to buy government securities. Since 70% of the government's budget is financed by banks buying government securities, the government would be faced with a widening budget deficit and consequent weakness of the leke. Bankers estimate that a 10-15 percent loss of deposits could force banks to stop buying government securities.

¶6. (C) Although Albania's exchange rate with the Euro has held steady for several years, an increasing budget deficit or worsening of the trade balance could cause the leke to weaken. (Note: Albania's largest exports are shoes and clothing destined for high-end stores in Europe and the U.S.)

That would give rise to yet another problem. Albania's consumer credit has been growing at a very rapid rate - too rapid according to the IMF. Since Albanians have become used to a stable exchange rate, many consumer loans have been taken in Euros to get better interest rates. A weakening of the leke could further raise the loan default level, which is already a concern (reftel).

Comment

¶7. (C) Berisha's sugarcoating of the recent EU progress report sent a clear message to the international community that he does not intend to acknowledge any problems, political or economic, ahead of the elections. While Albania has no control over external factors that could affect its economy, Berisha could take some reasonable precautions. For instance, the IMF could provide a significant safety net, but Berisha clearly does not want to be constrained ahead of the elections by the fiscal discipline the IMF would require. He could also begin planning for a soft landing by beefing up welfare programs and creating jobs in existing and planned infrastructure programs. However, to do so he would have to admit that perhaps all is not so rosy on Albania's economic front. In fact, a real nightmare scenario for Berisha would be a run on the banks coupled with electricity blackouts just before the elections. He would have no one to blame.

WITHERS